MINISTRY: FINANCE
REPUBLIC OF SOUTH AFRICA
Private Bag x115, Pretoria, 0001 • Tel: +27 12 323 8911• Fax: +27 12 323 3262
PO Box 29, Cape Town, 8000 • Tel: +27 21 464 6100 • Fax: +27 21 461 2934

International Corporate Governance Network

12th Annual Conference 4-6 July 2007

Trevor A Manuel, MP

Minister of Finance, South Africa

Master of Ceremonies

The ICGN Board, headed by Mark Anson

The ICGN Secretariat and its Executive Director Anne Simpson

The Head of the Conference Organsing Committee Phil Armstrong

The Head of the South African Planning Committee Geoff Rothschild

We are honoured to have with us:

Charlie Maccreevy, EU Commissioner for the Internal Market and Services, Ireland

Roel Campos, Commissioner Securities Exchange Commission, USA

Distinguished delegates

There was a time, long before it was thought useful or responsible to connect the words “corporate” and “governance”, when it was understood that the privilege of corporate identity has its roots in an act of government charter: that it is the law that makes possible

the separation of a corporation from its shareholders or owners, and it is the law that defines the special privileges and obligations of directors in their agency role between stockholders and managers.

These special arrangements have provided a powerful engine of economic and technological progress: simple proprietorships or partnerships could not have mobilised the capital, or taken the industrial risks or combined resources on the scale that has been possible in the modern corporation. But there have always been risks of abuse or exploitation of these privileges, and so there has always been a struggle against the veil of secrecy that protects corporate decision-making. Indeed, modern company law and labour legislation are at least in part about lifting this veil and imposing civilizing standards in the boardroom and the corporate workplace, precisely because the power of an undisciplined charter is so great, and its obligations so easily corrupted.

Adam Hochschild's book *King Leopold's Ghost* provides an eloquent reminder of just how extreme the human horrors were that accompanied exploitation of central Africa's ivory, rubber and mineral resources behind the veil of an unconstrained corporate charter. He also reminds us of the courage and persistent application of those who uncovered and opposed the pillaging and rape of Africa's heritage and people, in newsletters that were distributed through charitable organisations and in public petitions, Sunday sermons and occasionally successful law-suits, and through popular resistance and acts of sabotage. The corporate extravagances that have captured headlines in more recent times have perhaps more often involved financial treachery than human brutality. But it is still the case, in the 21st century, that respected corporations take advantage of exploitative labour conditions or weak environmental standards in developing countries. And it is still the case, in the 21st century, that human rights organisations, investigative journalists and local anger play at least as prominent a role in exposing the abuse of corporate power as do official multilateral agencies and national regulatory bodies.

And so it is still the case, even with the great expansion of corporate statutes and the codification internationally of rights and responsibilities and obligations in more detail than any of us have patience for, that the law is not enough.

The law is not enough, and we surely would not want to live in a world in which we relied only on the law for the protection of human worth and the integrity of social partnerships.

If the law is not enough, then compliance with the law is not enough, and we have to put the spotlight also on what we understand by fiduciary responsibility and corporate identity.

Indeed, it is possible that the law and its compound multipliers in the form of regulatory agencies and their minutiae of instrumentalities try to do too much, and so the resulting culture of technical compliance, often delegated to secretarial officers, is counterproductive. It is not so much that the law is inadequate, which it is, or even that every codification leads to a plethora of innovative reactions which themselves require regulatory response – it is not so much this ever-widening scope of the formal constraints, but it is the complementary relaxation of discretionary judgment in the boardroom that is of concern.

The problem of an undue burden of formal compliance is rightly on your conference agenda, and your programme convenors have been so bold as to question whether regulators are a help or a hindrance. There will be lively discussion of this, I am sure: let me simply suggest that the answer depends at least in part on how directors and managers *respond* to regulatory interventions. If there is a tendency to react formalistically and dispense with intelligent judgment in the face of regulatory challenges, instead of an interactive engagement with the underlying issues, then there is every risk of a descent into a bureaucratic gridlock.

Of parallel concern is the tendency to codify and quantify risks in analytically demanding ways. Technical analysis of risks is a non-trivial undertaking and may yield important insights. But all too often it leads to elaborate and impenetrable reporting formats, excessive board paperwork and an uncomfortable presumption that whoever compiles the reports must know what's going on and is dealing with whatever it is that the graphs and numbers and algebra are signaling.

Rigorous analysis has an important place in the corporate oversight chain, but it should not be allowed to throw a blanket of obfuscation over the ordinary monitoring and reporting functions. More information may bring additional insights, but there are also risks associated with information overload and unwarranted complexity. Simple, accessible styles of communication are a pre-requisite for effective corporation governance, and not just in small enterprises but most especially in large many-layered multi-objective organisations.

The important point is that by keeping issues or options clear and communicating effectively, there is a better prospect of an intelligent discourse and real engagement with responsibilities and alternatives. On the subject of information and how it is organised, generalisations are unhelpful: every company, every project, every problem needs the light of a particular window, its own illuminating lens. But we should also understand that as accounting and analytical systems evolve further in complexity and detail, so the burden of keeping pace or of catching up becomes that much more onerous for small firms or for developing countries. Where straightforward systems can do the job, they should be retained; the additional cost of complexity needs to be carefully weighed against its benefits.

Complexity should not be confused with formalisation.

Allen Schick is an economist whose insights into budget systems and public sector financial management have assisted so many countries through these reforms over several decades. In a recent paper he presents a compelling account of how formalisation of decision-making, over time, contributes to steady improvements in the quality of public resource allocation. Formalisation means the replacement of arbitrariness and accidental privilege with systematic processes and laws of general application. But Schick is also alive to the risk of developing countries trying to leapfrog over these institutional developments by adopting modern infrastructure and systems all at once. He warns, for example, against trying to implement full-blown accrual accounting systems when the professional capacity needed is not in place. The consequence of premature formalisation of complex requirements is that the modern parts of these countries prosper while lagging communities or sectors are left further behind.

If the templates put forward as formal models are unduly complex, then they are unlikely to be effectively implemented and the results will be unpredictable and arbitrary. Indeed, the institutional origins of fraud and corruption are frequently to be found in failed attempts to implement inappropriately complex management and control systems.

So when you give consideration, as you will, to the question: do investors have a role in corruption? – I would suggest that you also ask whether inappropriate management information and governance systems also play some role in this dynamic.

Let me return, by way of conclusion, where I began, which is the symbiotic relationship between the law and the corporation. There is an obvious point to make, which is that effective and healthy corporate governance arrangements are needed as much in the public sector as they are in private business enterprises. This is true and it bears emphasis, because questions of how to measure and reward performance, how to manage conflicts of interest, how to structure information for executive decision-making efficiently, how to articulate and manage competing objectives and priorities, how to identify and manage risks – these are problems of agency and accountability whether the corporate proprietor is an array of private stockholders or a government acting on behalf of its citizens.

But it is not the commonality but the different roles and responsibilities that I want to leave with you. The idea of fiduciary responsibility of the directors of a corporation – the idea that it is right and proper to act in the particular interests of the corporate entity, without special regard to other interests – is given intellectual force by the idea of competition, that the market process sets limits to the abuse of power, subject to the common constraints of the law. Corporations act in the interests of their shareholders, while it is the responsibility of government to look after the wider public interest, to provide an appropriate legal framework, to protect the weak and the vulnerable, to attend to externalities and market failures – to address, in other words, the "other interests" that might otherwise trouble the consciences of responsible directors.

This is a tidy bit of neoclassical theory, but on reflection it raises troubling concerns. These days we know – think of climate change or avian flu – that externalities cannot adequately be dealt with by individual countries' sovereign laws. These days we know – think of tax laws and labour standards – that investment decisions and global production can be driven by factors that are very remote from the optimal resource allocation criteria of the microeconomics textbook. These days we know – think of accounting practice – that access to information is highly asymmetric and imperfectly regulated.

And so we need to understand that sound corporate governance is not enough. We have shared interests – as citizens, as responsible inhabitants of an abused planet earth, as partners in the challenge of creating a fairer world in which opportunity and assets are more broadly held. These shared interests will not be addressed by corporations acting in

keeping with their narrow self-interest, nor can they be addressed by governments acting alone, or even by governments and public interest organisations acting in concern internationally. They also require a broader concept of corporate responsibility than the idea of governance that presently enjoys popular currency. And so this conference provides an opportunity to reflect on the challenges and opportunities for deepening governance and accountability, but also perhaps to explore beyond the frontiers of corporate identity, because just as we exist, as human beings, through others, so also the responsible corporation has its identity in part through the values and commitments it shares with others.